

## Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 EURE-00 SP-02 USIA-06 AID-05 EB-07

NSC-05 CIEP-01 TRSE-00 SS-15 STR-04 OMB-01 CEA-01

CIAE-00 COME-00 FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03

LAB-04 SIL-01 L-03 SAM-01 IO-13 /097 W  
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P R 131751Z SEP 76

FM AMEMBASSY LISBON

TO SECSTATE WASHDC PRIORITY 8502

INFO AMEMBASSY BONN

USMISSION EC BRUSSELS

C O N F I D E N T I A L SECTION 1 OF 2 LISBON 6245

DEPARTMENT PASS DEPARTMENT OF TREASURY SYVRUD

E.O. 11652: GDS

TAGS: EAID, PO

SUBJECT: GOP ECONOMIC PROGRAM AND LOAN REQUEST

REFS: (A) STATE 225469, (B) LISBON 6223

SUMMARY: I MET THIS AFTERNOON WITH THE MINISTER OF FINANCE AND THE BANK OF PORTUGUESE GOVERNOR TO REVIEW GOP ECONOMIC POLICIES. AFTER NOTING THAT WASHINGTON AGENCIES STILL HAD A NUMBER OF QUESTIONS, I STATED THAT DONALD SYVRUD WOULD BE RETURNING TO DISCUSS GOP ECONOMIC POLICIES. I EMPHASIZED THAT HE WOULD NOT BE COMING TO NEGOTIATE A LOAN. GOP OFFICIALS READILY ADMITTED NEED TO REDUCE BUDGET DEFICIT. THEY ALSO CONCEDED THAT DEVALUATION WOULD BE NECESSARY, BUT INSISTED THAT IT CANNOT BE UNDERTAKEN UNTIL LABOR PRODUCTIVITY HAS BEEN RESTORED. THEY WERE LESS DISPOSED TO RAISING INTEREST RATES SUBSTANTIALLY, AT LEAST UNTIL LOAN DEMAND HAS RISEN TO MATCH CREDIT AVAILABILITY. END SUMMARY.

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1. ECON COUNSELOR AND I MET WITH MINISTER OF FINANCE AND BANK OF PORTUGAL GOVERNOR THIS AFTERNOON. I BRIEFLY REVIEWED EARLIER DISCUSSIONS WITH PRIME MINISTER SOARES AND THEN MINISTER OF FINANCE ZENHA REGARDING GOP REQUEST FOR A LOAN. ON THE BASIS OF THOSE DISCUSSIONS, I NOTED, WE HAD INFORMED WASHINGTON OF THE GOP REQUEST. WASHINGTON AGENCIES HAVE, THEREFORE, BEEN FOLLOWING PORTUGUESE DEVELOPMENTS CLOSELY, PARTICULARLY PRIME MINISTER SOARES'S ADDRESS OF LAST THURSDAY. THEY APPRECIATED PRIME MINISTER'S EMPHASIS ON THE NEED TO RESTORE LABOR PRODUCTIVITY, BUT STILL HAD QUESTIONS ON OTHER ISSUES, SUCH AS THE PUBLIC SECTOR BUDGET, EXCHANGE POLICY AND INTEREST RATES. I REPORTED THAT DONALD SYVRUD WOULD BE RETURNING FOR ANOTHER VISIT. RATHER THAN COME TO STUDY THE ECONOMIC SITUATION, HOWEVER, HE WOULD COME TO REVIEW GOP ECONOMIC POLICIES. I EMPHASIZED THAT HE WOULD NOT REPEAT NOT COME TO NEGOTIATE A BILATERAL LOAN. THEY RECALLED SYVRUD AND SAID HE WOULD BE MOST WELCOME.

2. THE TWO PORTUGUESE OFFICIALS THEN DISCUSSED EXTENSIVELY THE THREE ECONOMIC ISSUES WHICH I HAD MENTIONED. SUMMARY OF THEIR COMMENTS FOLLOWS:

A. PUBLIC SECTOR BUDGET -- BOTH OFFICIALS READILY ADMITTED THAT PUBLIC SECTOR DEFICIT MUST BE CURTAILED. EFFORTS WOULD BE MADE TO REDUCE DEFICIT DURING REMAINING MONTHS OF 1976, BUT PRINCIPAL EFFORT IS BEING PLACED ON BUDGET FOR 1977. LATTER BUDGET IS CURRENTLY UNDER PREPARATION FOR SUBMISSION TO CONGRESS. MAJOR PROBLEM CONFRONTING GOP IS EXISTENCE OF NUMEROUS AUTONOMOUS FUNDS, NOTABLY SOCIAL SECURITY FUND AND SUPPLY FUND, WHICH ARE ACCUMULATING TREMENDOUS DEFICITS. IN ADDITION, THE NUMBER OF SUBSIDIES, PARTICULARLY FOR REFUGEES FROM AFRICA, HAS GROWN CONSIDERABLY. GOP IS DETERMINED TO REDUCE THESE CONSUMER OUTLAYS, EVEN THOUGH IT RECOGNIZES THE DIFFICULTY OF DOING SO.

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B. EXCHANGE POLICY -- BOTH OFFICIALS, THOUGH MINISTER OF FINANCE WAS SOMEWHAT MORE HESITANT, ACKNOWLEDGED THAT DEVALUATION WILL BE NECESSARY. THEY INSISTED, HOWEVER, THAT DEVALUATION AT THIS TIME WOULD HAVE LITTLE POSITIVE EFFECT, AND INDEED MIGHT BE NEGATIVE. DEVALUATION, THEY MAINTAINED, CAN BE UNDERTAKEN ONLY AFTER NECESSARY CHANGES IN LABOR POLICY ARE UNDERWAY AND THE

NATION'S PRODUCTIVITY HAS INCREASED SUFFICIENTLY TO PERMIT IT TO TAKE ADVANTAGE OF A DEVALUATION. THEY ARE UNABLE TO ESTIMATE HOW LONG GOP WOULD REQUIRE TO ESTABLISH APPROPRIATE CONDITIONS FOR A DEVALUATION. CONTEXT OF THE DISCUSSION SUGGESTED, HOWEVER, THAT THEY WERE THINKING OF A TIME SPAN OF FROM TWO TO FOUR MONTHS.

C. INTEREST RATES -- CONSIDERABLE DIFFERENCE OF OPINION APPARENTLY EXISTS ABOUT THE DESIRABILITY OF RAISING INTEREST RATES SIGNIFICANTLY. BANK OF PORTUGAL GOVERNOR SILVA LOPES EXPRESSED A WILLINGNESS TO INCREASE THEM BY 3 OR 4 PERCENTAGE POINTS IMMEDIATELY, BUT STATED THAT OTHER PORTUGUESE ECONOMISTS RESIST EVEN THIS LEVEL OF INCREASE. HE ACKNOWLEDGED THAT A NUMBER OF FOREIGN ECONOMISTS HAVE URGED A VERY SHARP RISE IN PORTUGAL'S NEGATIVE INTEREST RATES. FROM THE BALANCE OF PAYMENTS POINT OF VIEW, HE CONCEDED, THOSE ARGUMENTS ARE LEGITIMATE. FROM DOMESTIC POINT OF VIEW, HOWEVER, HE FELT HIGH INTEREST RATES WOULD CAUSE MORE HARM THAN GOOD. THEY WOULD, FOR EXAMPLE, DISCOURAGE INVESTMENTS, PLACE A HEAVY FINANCIAL BURDEN ON THE TREASURY, AGGRAVATE FINANCIAL PROBLEMS OF INNUMERABLE PRIVATE FIRMS, AND IMPOSE FURTHER BURDENS ON SUCH WEAK SECTORS AS CONSTRUCTION. PORTUGAL'S SITUATION

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FM AMEMBASSY LISBON

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C O N F I D E N T I A L SECTION 2 OF 2 LISBON 6245

IS DIFFERENT FROM OTHER NATIONS WHICH HAVE, LARGELY BECAUSE OF NEGATIVE INTEREST RATES, FACED AN EXCESS DEMAND FOR CREDIT. IN FACT, CREDIT DEMAND IS SUBSTANTIALLY BELOW CURRENT SAVINGS, LARGELY BECAUSE PORTUGUESE PUBLIC CONTINUES TO SAVE DESPITE NEGATIVE INTEREST RATES. THE IMBALANCE WOULD BE EVEN GREATER IF THE PUBLIC SECTOR WERE NOT SUCH A HEAVY BORROWER. SPEAKING PERRSONALLY, SILVA LOPES SAID THAT HE WOULD BE DISPOSED TO RAISE INTEREST RATES VERY SUBSTANTIALLY ONCE DEMAND FOR CREDIT APPROACHES TOTAL SAVINGS AVAILABILITY. IN ANY CASE, HE SAID, AND PARTICULARLY SINCE THE BALANCE OF PAYMENTS ARGUMENT IS CLEARLY CORRECT, THIS SUBJECT IS STILL OPEN TO FURTHER DISCUSSION. AMONG THE NECESSARY SERIES OF ECONOMIC MEASURES, HOWEVER, INTEREST RATE ADJUSTMENT WOULD PROBABLY BE ONE OF THE LAST.

3. COMMENT: GOP OFFICIALS APPARENTLY HAVE GIVEN CONSIDERABLE THOUGHT TO THE MAJOR ECONOMIC ISSUES DISCUSSED ABOVE. ALTHOUGH THEY AGREE ON THE MAJOR OBJECTIVE, THEY CLEARLY FEEL THAT THE FIRST  
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PRIORITY IS LABOR/MANAGEMENT RELATIONS AND LABOR PRODUCTIVITY. UNTIL THEY HAVE RESOLUTION OF THESE PROBLEMS UNDERWAY, THEY DO NOT BELIEVE THAT OTHER POSSIBLE ECONOMIC TOOLS CAN HAVE A POSITIVE IMPACT.  
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